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**¶1.** (SBU) Madame Secretary, I would like to extend a warm welcome from Team Italy in anticipation of your trip to participate in the G8 Labor Ministerial. The Labor Ministerial will be the first full G8 ministerial and it offers an excellent opportunity to highlight the new Administration's policies in the context of this key organization. Your trip comes at a critical moment as the Berlusconi government seeks to understand how it fits into the new Administration's reengagement with Europe. Your visit is an opportunity to deepen our engagement on the global financial crisis which is rapidly undermining Italy's economy. The financial crisis has not yet had the same immediate impact in Italy as it has had in other countries, but as the economic downturn reverberates through Italy's export-dependent economy, existing social tensions could worsen. Italy will use the Labor Ministerial to discuss strategies to tackle the impact of the economic crisis on the labor market, and intends to feed these ideas into other international summits, including the G20 meeting taking place in London on April 2.

G8: The Ever-Growing Agenda

**¶12.** (SBU) Italy's ambitious list of priorities for its G8 Presidency include global financial governance, energy and climate change, Afghanistan, peacekeeping and development (particularly in Africa), food security and non-proliferation. Italy will host a record nine G8 Ministerials this year, culminating in the G8 Summit at La Maddalena, Sardinia. Italy plans a greater role for the G8's traditional Outreach session, by seeking greater involvement from the "Outreach Five" (China, India, South Africa, Brazil and Mexico) in the final Summit Declaration and by inviting Egypt. By expanding both the scope and the participation in the Summit, Italy runs the risk of diluting the agenda and duplicating efforts in areas like financial governance which are normally the purview of the G7 and G20.

Financial Crisis: Banks OK, But Economy Suffers

**¶13.** (SBU) Because of a somewhat conservative banking sector, Italy did not suffer the kind of financial meltdown experienced elsewhere. Italian banks had little reason to engage in sub-prime lending, or buy significant assets derived from sub-prime loans overseas, given their dominance in their own high-margin, low-risk domestic market. All the same, they were caught in the worldwide economic downturn at a time when earnings -- as opposed to asset quality -- were already coming under pressure due to Italy's anemic economic

performance the previous 3 years. Italy is now fully into a serious economic slowdown, with some economists predicting a GDP drop of almost 3 percent in 2009, the largest drop since 1975, when production shrunk by just over 2 percent. The Berlusconi government has managed the public aspects of the crisis fairly well, focusing initially on maintaining the public's confidence in the banking system. Italy has participated fully in the global coordinated response to the crisis, taking limited measures aimed at re-starting interbank lending and strengthening Italian banks' capital. The government implemented a modest economic stimulus package, which includes tax incentives for purchasers of some durable goods and autos. Italy has a limited ability to respond to this crisis with additional government spending because of its already very high government debt levels (around 104% of GDP).

**14.** (SBU) Italy has shed relatively few jobs since the economic crisis began, but the crisis here is likely to deepen before it gets better, and Italy's relatively low unemployment rate of 6.1 percent in 2008 is likely to rise to over 7 percent by year end. The government's main concern is for the large segment of the workforce that is employed on temporary contracts (shut out of the workforce by costly government-mandated employee benefits) who will likely bear the brunt of job cuts. Unemployment numbers can be deceptive, moreover, because of the very diverse labor picture across the country, with nearly full employment in the industrialized north, and unemployment rates at 20 percent or higher in some parts of the underdeveloped south. Labor unions continue to play a major role in Italian politics and determining labor contracts, but their influence is nowhere near where it stood ten years ago. Labor unions have declined in influence as the political system has evolved and most recently as the left--and particularly far left--have been

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marginalized.

**15.** (SBU) The social dimensions of the economic crisis have thus far been relatively minimal, however with the expected rise in unemployment and decline in exports, increased strains are likely. Rising unemployment could lead to greater anti-immigrant sentiment and some sense of competition for jobs. The slowing of the economy and diminished labor opportunities will particularly worsen the already difficult labor market for youth. While Interior Ministry contacts expect primarily economic immigrant flows to slow, immigrants from sub-Saharan Africa fleeing war, instability or persecution will continue to arrive and will find diminished opportunities to find work and integrate into Italian social life.

Domestic Politics: Berlusconi in Control, but Challenges Emerging

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**16.** (SBU) After two years of a divided center-left government, Italy saw Silvio Berlusconi return to power last year. Berlusconi enjoys a broad base of power that has allowed him to use his first months back in office to deliver results on election promises, though long-term solutions to most problems are still needed. The trash problem in Naples is not yet permanently solved, but the streets are cleared and troops are keeping dumps and incinerators open. Public worries about street crime have been addressed by a sweeping new security law. A public finance law has overhauled the annual budget process, which traditionally has eaten up months of Parliament's time, but Italy's faltering economy casts doubt on whether budget targets will be met. Berlusconi's government drafted and passed these laws mostly without consulting the center-left opposition, which has grown more fragmented.

Organized Crime: Slowing Growth and Fraying the Social Fabric

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17. (SBU) Organized crime remains a serious and pervasive problem throughout the country, particularly in the South. Crime syndicates are engaged in trafficking in drugs, arms and persons; extortion; the production and distribution of pirated and counterfeit products (including American movies, music and software); illegal construction; loan sharking; and illegal dumping of toxic waste. While there are some glimmers of hope (in Sicily, dramatic law enforcement successes and changing public attitudes have created severe problems for the Cosa Nostra's traditional hold on the island), these successes have not been replicated elsewhere. The Camorra remains deeply entrenched in Campania, and Calabria is the base for Western Europe's largest Mafia group, the 'Ndrangheta. There are large swaths of territory in southern Italy where the state is nearly completely absent and the crime syndicates control most facets of society and the economy. These groups create a huge drag on Italy's economic growth and its ability to apply the rule of law. Worsening economic conditions may further strengthen the grip of organized crime in some of Italy's least economically developed regions.

Conclusion

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18. (SBU) Despite its economic malaise, Italy remains a close and reliable partner and will continue to be an important ally for the U.S. in NATO, the region and around the globe, especially in key international security partnerships in Afghanistan, the Balkans, and the Middle East. Italy's slowing economy, with unemployment set to rise, will lead to rising social tensions, particularly affecting those on the margins of Italy's faltering economy--youth and immigrants. Italy's Labor Ministry intends to use this summit as a platform to discuss ways to help the labor force adjust to the economic crisis, without reverting to protectionism or allowing labor standards to be relaxed. Italy also intends for the conclusions of this ministerial to be relevant to the G20 in April, the OECD ministerial meeting in June, and the G8 leaders summit in July. The Italian government will welcome your participation at the Labor ministerial, which is the first full G8 ministerial, as evidence of the enduring strength of our bilateral relationship.

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